



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Richard Doyle
City Attorney

SUBJECT: Telephone Users Tax

DATE: 6/26/2006

RECOMMENDATION

Adoption of an urgency ordinance and approval of a regular ordinance amending Section 4.68.080 of Chapter 4.68 of Title 4 of the San José Municipal Code to clarify that the City's application of the telephone users tax to intrastate telephone communications services has been and will continue to be consistent with the Internal Revenue Service's interpretation of the Federal Excise Tax prior to May 25, 2006.

OUTCOME

The adoption of this urgency ordinance and approval of a regular ordinance will clarify the City's application of its telephone users tax.

BACKGROUND

Since 1970, the City of San José has imposed a telephone users tax on every person in the City using intrastate telephone communication services. Presently, the tax is imposed at a rate of 5% of the charges billed. The City's tax has been applied consistent with the application of the Federal Excise Tax (FET) upon local and long distance telecommunication services as the FET is interpreted by the Internal Revenue Service (IRS).

On May 25, 2006, the Treasury Department issued Notice 2006-50 in which it announced it is conceding the legal dispute over whether it should be applying the FET to long distance and bundled telecommunication services, where the charges for the services are based on time only and not time and distance. Consequently, effective August 1, 2006, the IRS will no longer apply the FET to long distance and bundled service. Bundled service is local and long distance service provided under a single plan that does not separately state the charges for local telephone service. The Treasury Department's May 25 Notice reversed its prior Revenue Rulings and interpretation of the FET, which the City has relied upon in applying its telephone users tax to telecommunication services.

ANALYSIS

The proposed ordinances are not intended to be construed as imposing a new tax, or extending or increasing an existing tax. Instead, by this amendment to the telephone users tax, the City reaffirms that it will continue its long-standing practice of applying its tax in a manner consistent with the IRS' interpretation of the FET prior to Notice 2006-50 issued by the Treasury Department on May 25. The proposed ordinances clarify that the City is not changing its application of its telephone users tax based on the IRS' decision to discontinue taxing long distance and bundled services in order to resolve legal disputes with telephone customers. Rather, the City wishes to continue to tax intrastate local, long distance, and bundled services as it always has — based upon the IRS' interpretation of the FET prior to May 25, 2006.

Pursuant to Section 605 of the City's Charter, the proposed urgency ordinance will become effective immediately upon its adoption. Adoption of the proposed urgency ordinance is necessary for the immediate preservation of public peace, health or safety. The revenues from the telephone users tax are anticipated to be approximately \$25 million dollars for Fiscal Year 2006-2007 if the telephone users tax is applied consistent with the IRS' interpretation of the FET prior to the issuance of Notice 2006-50. In the event that the City's telephone users tax were to be applied consistent with Notice 2006-50, City staff projects that the total telephone users tax revenues for Fiscal Year 2006-07 could decrease by approximately \$16 million dollars. The revenues from the telephone users tax are critical to the public peace, health and safety in that these revenues pay the costs associated with essential services, including public safety.

Both the proposed urgency ordinance and the regular ordinance are attached to this memorandum.

ALTERNATIVES

The City Council could choose to not adopt the proposed urgency ordinance or regular ordinance and to stop collecting the City's telephone users tax on long distance and bundled services.

PUBLIC OUTREACH

Notice of the approval of the proposed regular ordinance will be published in the newspaper as required by law.

COORDINATION

The City Manager's Office is aware of the proposed ordinances.

HONORABLE MAYOR AND CITY COUNCIL

June 26, 2006

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CEQA

Not a Project.

RICHARD DOYLE

City Attorney

By

A handwritten signature in cursive script, reading "Karin Murabito", written over a horizontal line.

Karin Murabito

Deputy City Attorney

cc: Les White

For questions please contact Karin Murabito, Deputy City Attorney, at 535-1900.

ORDINANCE NO. _____

**AN URGENCY ORDINANCE OF THE CITY OF SAN JOSE
AMENDING SECTION 4.68.080 OF CHAPTER 4.68 OF TITLE 4 OF
THE SAN JOSE MUNICIPAL CODE TO CLARIFY THAT THE CITY'S
APPLICATION OF THE TELEPHONE USERS TAX TO INTRASTATE
TELEPHONE COMMUNICATIONS SERVICES HAS BEEN AND
WILL CONTINUE TO BE CONSISTENT WITH THE INTERNAL
REVENUE SERVICE'S INTERPRETATION OF THE FEDERAL
EXCISE TAX PRIOR TO MAY 25, 2006 AND SETTING FORTH THE
FACTS CONSTITUTING SUCH URGENCY**

WHEREAS, since 1970, the City of San José ("City") has imposed a telephone users tax on every person in the City using intrastate telephone communication services; and

WHEREAS, the City's telephone users tax has been applied consistent with the application of the Federal Excise Tax (FET) upon local and long distance telecommunication services as the FET is interpreted by the Internal Revenue Service (IRS); and

WHEREAS, on May 25, 2006, the Treasury Department announced in Notice 2006-50 that effective August 1, 2006, it will no longer apply the FET to long distance and bundled long distance and local service provided under a single plan that does not separately state the charges for local telephone service; and

WHEREAS, the Treasury Department's Notice 2006-50 reverses its prior Revenue Rulings and interpretation of the FET, which the City has relied upon in applying its telephone users tax; and

WHEREAS, by the adoption of this Ordinance amending the telephone users tax, the City reaffirms that it will continue its long-standing practice of applying its telephone users tax in a manner consistent with the IRS' interpretation of the FET which was in effect prior to the issuance of Notice 2006-50 on May 25, 2006;

NOW THEREFORE, BE IT ORDAINED BY THE COUNCIL OF THE CITY OF SAN JOSE:

SECTION 1. Section 4.68.080 of Chapter 4.68 of Title 4 of the San José Municipal Code is amended to read as follows:

4.68.080 Telephone Users Tax

- A. Imposition of Tax. Every person in the city using intrastate telephone communication services, other than a telephone corporation shall pay a tax at the rate of five percent (5%) of the charges billed for such services, including charges for service. The service user shall pay the tax to the service supplier at the same time as and along with payment of the charges billed for the services.
- B. Coin-operated Telephones and Mobile Services. As used in this Section, the term "charges" shall not include charges for services paid for by inserting coins in coin-operated telephones, except that where coin-operated telephone service is furnished for a guaranteed amount, the amounts paid under such guarantee plus any fixed monthly or other periodic charge shall be included in the base for computing the amount of tax due. The words "telephone communication services" shall not include land mobile services or maritime mobile services as defined in Section 2.1 of Title 47 of the Code of Federal Regulations as that Section existed on May 24, 2006.
- C. Exemptions. Notwithstanding the provisions of subsection A of this Section, a tax shall not be imposed upon any person for using intrastate telephone communication services to the extent that the amounts paid for such services are exempt from or not subject to, the tax imposed under Section 4251 of Title 26 of the United States Code, as that Section was interpreted by the Internal Revenue Service before May 25, 2006.

- D. Duty of Seller. The person selling the intrastate telephone communication services shall collect the tax from the service user and shall remit the tax to the Director.
- E. Procedure. The procedure for collection and remittance of the tax is set forth in Sections 4.68.110 et seq.

SECTION 2. If this Ordinance is declared to be invalid, then the provisions of Section 4.68.080 as that Section read on June 26, 2006 will become effective.

SECTION 3. This Ordinance shall not be construed as imposing a new tax, or extending or increasing an existing tax.

SECTION 4. This Ordinance is declared by the City Council to be an urgency measure necessary for the immediate preservation of public peace, health or safety. The facts constituting such urgency are as follows: The revenues from the telephone users tax are anticipated to be approximately \$25 million dollars for Fiscal Year 2006-2007 if the telephone users tax is applied consistent with the IRS' interpretation of the FET prior to the issuance of Notice 2006-50. In the event that the City's telephone users tax were to be applied consistent with Notice 2006-50, it is projected that the total telephone users tax revenues could decrease by approximately \$16 million dollars for Fiscal Year 2006-07. The revenues from the telephone users tax are critical to the public peace, health and safety in that these revenues pay the costs associated with essential services, including public safety.

SECTION 5. This Ordinance shall become effective immediately upon its adoption pursuant to Section 605 of the Charter of the City of San Jose, and shall remain in effect until the effective date of the superseding Ordinance.

ADOPTED this 27th day of June, 2006, by the following vote:

AYES:

NOES:

ABSENT:

DISQUALIFIED:

RON GONZALES
Mayor

ATTEST:

LEE PRICE, MMC
City Clerk

ORDINANCE NO. _____

AN ORDINANCE OF THE CITY OF SAN JOSE AMENDING SECTION 4.68.080 OF CHAPTER 4.68 OF TITLE 4 OF THE SAN JOSE MUNICIPAL CODE TO CLARIFY THAT THE CITY'S APPLICATION OF THE TELEPHONE USERS TAX TO INTRASTATE TELEPHONE COMMUNICATIONS SERVICES HAS BEEN AND WILL CONTINUE TO BE CONSISTENT WITH THE INTERNAL REVENUE SERVICE'S INTERPRETATION OF THE FEDERAL EXCISE TAX PRIOR TO MAY 25, 2006

WHEREAS, since 1970, the City of San José ("City") has imposed a telephone users tax on every person in the City using intrastate telephone communication services; and

WHEREAS, the City's telephone users tax has been applied consistent with the application of the Federal Excise Tax (FET) upon local and long distance telecommunication services as the FET is interpreted by the Internal Revenue Service (IRS); and

WHEREAS, on May 25, 2006, the Treasury Department announced in Notice 2006-50 that effective August 1, 2006, it will no longer apply the FET to long distance and bundled long distance and local service provided under a single plan that does not separately state the charges for local telephone service; and

WHEREAS, the Treasury Department's Notice 2006-50 reverses its prior Revenue Rulings and interpretation of the FET, which the City has relied upon in applying its telephone users tax; and

WHEREAS, by the adoption of this Ordinance amending the telephone users tax, the City reaffirms that it will continue its long-standing practice of applying its telephone users tax in a manner consistent with the IRS' interpretation of the FET which was in effect prior to the issuance of Notice 2006-50 on May 25, 2006;

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- D. Duty of Seller. The person selling the intrastate telephone communication services shall collect the tax from the service user and shall remit the tax to the Director.
- E. Procedure. The procedure for collection and remittance of the tax is set forth in Sections 4.68.110 et seq.

SECTION 2. If this Ordinance is declared to be invalid, then the provisions of Section 4.68.080 as that Section read on June 26, 2006 will become effective.

SECTION 3. This Ordinance shall not be construed as imposing a new tax, or extending or increasing an existing tax.

PASSED FOR PUBLICATION of title this ____ day of _____, 2006, by the following vote:

AYES:

NOES:

ABSENT:

DISQUALIFIED:

RON GONZALES
Mayor

ATTEST:

LEE PRICE, MMC
City Clerk